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TAGS: ECON EFIN ETRD PREL YM
SUBJECT: WILL YEMENI TAX REFORM BE A TAXING EXPERIENCE?

Classified By: Deputy Chief of Mission Angie Bryan, per reasons 1.4 (b) and (d)

SUMMARY

¶1. (C) The ROYG is planning a phased implementation of a General Sales Tax on imported and wholesale goods in 2008 and expects to raise 112 billion Yemeni Riyals, according to the Tax Authority Chair. However, it will face several obstacles in collecting the tax. The Sana'a business community have raised a number of concerns about the tax, including its heavy administrative burden on small and medium enterprises (SMEs) and the corruption of tax officials. In order to address the public's concerns, the International Finance Corporation plans to implement a project to simplify business taxation and tax administration. However, the public and private sector have much work to do to narrow their differences on the GST issue. END SUMMARY

ROYG PURSUES PHASED GST IMPLEMENTATION . . .

¶2. (U) Since early 2006, the ROYG has embarked on a series of political and economic reforms under the National Reform Agenda. One focus of the the National Reform Agenda is fiscal reform, including making the taxation system more efficient, transparent and less corrupt. In July 2005, the Yemeni Parliament passed an amended General Sales Tax (GST) Law, which was scheduled to come into effect in early July ¶2006. The ROYG, however, delayed implementation due to intense public pressure and as a result reduced the overall GST rate from 10 to 5 percent. On April 18, 2007, the ROYG Tax Authority (TA) reached an agreement with the local Yemeni business community on a new mechanism for implementation of the General Sales Tax, whereby full implementation of the GST on importers would be delayed until the end of December 2008. For these importers, the agreement also sets new procedures for: a) dealing with arrears for the period from December 15, 2006 to April 30, 2007, and b) GST filing and assessment for the transitional period from May 2007-December 2008. The new provisions apply only to importers. The GST law is now being implemented fully on locally produced goods, with payments based on actual sales invoices, submitted through monthly declarations.

¶3. (C) In a January 14 meeting with Econoff, ROYG Tax Authority (TA) Chair Ahmed Ghaleb stated that the TA is planning a phased implementation of the GST at all customs points during 2008 and full implementation by January 1, ¶2009. He explained that the GST would be a "wholesale tax" and not a "consumer tax" (i.e. importers and wholesale merchants would have to pay the GST, but retail merchants and consumers would not have to pay it). According to Ghaleb, the GST would be applied at a rate of 5 percent on most goods

and services. A higher GST, however, would be applied to select items: khat (20 percent), cigarettes (90 percent) and arms and ammunition (90 percent). Certain goods would be exempt from the GST, including food/basic commodities, pharmaceuticals, health products, education, air transportation and financial/banking services. Ghaleb expects the TA to collect 112 billion Yemeni riyals from the GST in 2008, an increase of 12 billion Yemeni Riyals from the previous year.

. . . BUT COLLECTING THE TAX WILL NOT BE EASY

¶4. (C) Despite the ROYG's best intentions in applying an efficient and transparent tax regime, tax evasion is still prevalent in Yemen. For example, Ghaleb noted that smuggling of goods, like cigarettes, is rampant along Yemen's extensive land and sea borders. He also complained that importers at customs points declare only 20-30 percent of the true value of their goods in order to pay less taxes. He added that the Sana'a Chamber of Commerce and Industry (COCI) opposes the GST because it would expose their real profits and that many people do not want to keep accurate records. He claimed that the COCI misinformed the general public about the true nature of the GST, linking the GST to the high price inflation of basic commodities. As a result, Ghaleb believes that only 50 percent of taxes are collected. (Note: In its Summer 2007 Yemen Economic Update, the IMF recorded that tax revenues declined by 0.3 percent in 2007 from 2006. End note).

YEMEN'S TAX AUTHORITY "MOST CORRUPT ON EARTH"

¶5. (C) Sana'a COCI Board Member Jamal Almotareb expressed his disappointment about the ROYG's failure to fulfil its promises to the local business community in the April 2007 GST agreement. Almotareb stated that according to the agreement, the ROYG promised to a) delay GST implementation in order to simplify the procedures and restructure the Tax Authority; b) modify the income tax law in order to make it more suitable for investment; c) establish a committee to deal with the smuggling issue; d) establish a committee to determine the prices applied to imported goods and e) hire an international consulting firm in order to make the Yemeni business and investment climate more competitive. He said that ROYG has delivered on none of these five items.

¶6. (C) Almotareb called the TA "the most corrupt tax authority on earth" and said that the TA refused to listen to the local business community. He noted that the complexity of tax laws and administration creates corruption since many small and medium enterprises (which comprise 99 percent of the business community) do not have the administrative capabilities to follow all of the GST requirements. He added that rather than abiding by the law, many shopkeepers resort to the underground economy and try to bribe their way out.

¶7. (C) Another source of corruption, according to Almotareb, is the multiplicity of GST rates on different goods. He opined that the same GST rate should be applied across the board on all goods and services. He believed, however, that this step will not be possible in the current political climate where Parliamentarians have vested interests in certain industries. Almotareb stated that a third source of corruption was the "middlemen" involved in taxation between the Customs Authority and the ROYG Tax Authority. He argued that when a good or service is taxed at the customs point of entry, the revenues should be sent directly to a ROYG bank account without involvement of middlemen. (Note: "middlemen" refers to TA officials. End note.)

BUSINESSES COMPLAIN ABOUT HEAVY TAX BURDEN

¶8. (C) Many observers have noted that the current tax regime makes doing business in Yemen extremely difficult. In its "Doing Business 2008" report, the World Bank's

International Finance Corporation (IFC) indicated that entrepreneurs must make 32 tax payments per year, spend 248 hours on tax-related activities, and pay 41.4 percent of gross profits in taxes. Yemen ranked 84th in the world for paying taxes, according to the report. Almotareb warned that high tax rates will force certain businesses to close down, noting that 40 percent of businesses inside Sana'a went bankrupt in 2007. The oppressive tax regime, among other things, has caused businessmen to lose confidence in the investment climate in Yemen. Motareb said that 70 percent of Yemeni wealth is currently invested outside the country.

IFC'S TAX SIMPLIFICATION PROJECT TO ADDRESS COMPLAINTS

¶9. (C) In order to address the aforementioned concerns about tax policies and administration, the ROYG in December 2007 endorsed a project financed by the IFC to simplify business taxation and tax administration in Yemen. The project aims to simplify tax policies and procedures, improve the capacity of taxpayers and tax administrators, and reduce compliance costs within the next 18 months. On January 21, IFC Country Officer Saad Sabrah explained to Econoff that part of the project involves making the GST law as practical, transparent and easy as possible to implement. The project includes a) implementing a GST that would focus on voluntary compliance; b) streamlining procedures and forms required to comply; c) providing a public outreach and education program on the GST; d) implementing a GST audit program; and e) training senior Tax Authority officials in risk-based auditing.

COMMENT

¶10. (C) Post recognizes the ROYG's attempts to make the tax regime more efficient and transparent, as evidenced by the amended GST law, the IFC project and a draft bill before Parliament, which would lower the corporate income tax rate from 35 to 20 percent. Unfortunately, there is still deep distrust between the ROYG and business community on the issue of taxes. Declining oil revenues will force the ROYG to be more aggressive in collecting taxes. Whether GST implementation will be successful in 2008 remains to be seen. Post will continue to encourage the public and private sectors to continue dialogue and the ROYG to develop awareness of the GST and related issues. Post will continue to advise the Tax Authority to create strong instruments for combating corruption, including clear laws and mechanisms for receiving public complaints. End comment

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